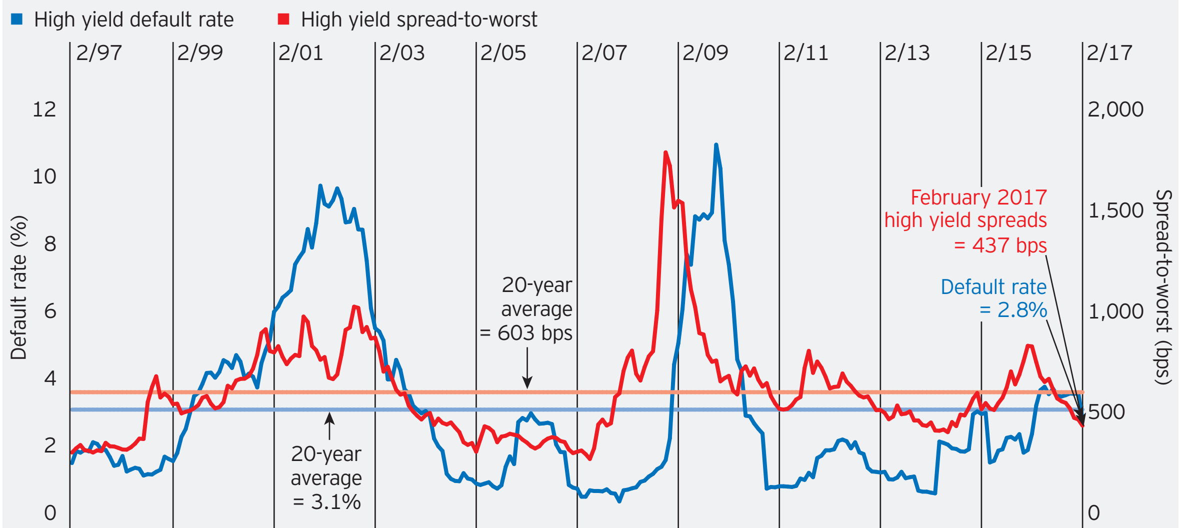
High Yield Snapshot

Monthly high yield bond market update: March 2017

The high yield market posted a strong return in February with the Bloomberg Barclays US Corporate High Yield 2% Issuer Capped Index advancing 1.45%. Continued post-election optimism stemming from the expectation of a more favorable regulatory environment, new fiscal stimulus, and expectations of stronger global economic growth helped propel the high yield market during the month. Spreads ended the month at 437 basis points (bps), which is over 150 bps below the 20-year average level. Five-year and ten-year Treasury yields were largely unchanged at 1.9% and 2.4%, respectively. We continue to believe the market has changed from a rising tide to one where careful credit and sector selection will likely be the key drivers of performance for 2017.

Spreads are below long-term averages



Source: JP Morgan, as of February 28, 2017

February performance by rating[1]

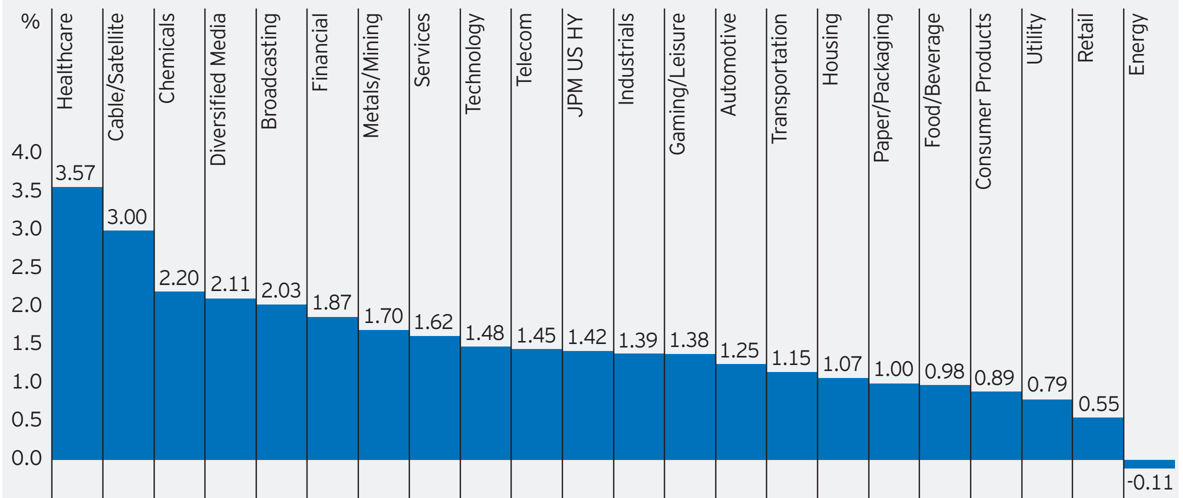
Within the ratings categories:

- BB-rated securities returned 1.09%
- B-rated securities returned 1.28%
- CCC-rated securities returned 2.74%

Earnings trends

Q4 earnings are largely behind us. Here are some themes from our analysts:

- Healthcare and pharmaceutical company results will continue to be a focus as likely changes to the Affordable Care Act are being discussed. While it's too early to know the outcome, we do expect continued negative earnings pressure on both of these sectors.
- Retail earnings continue to suffer from changing buying patterns and behaviors. We think careful credit selection is paramount to outperforming in this troubled sector over the coming months. We note average yields in this sector are far greater than the overall market, a condition unlikely to change in the near-term given the stress in the sector.
- Energy service earnings have improved slightly, but remain at depressed levels. Within this sub-sector, land based earnings are improving while offshore earnings are still declining. This has been a positive trend for land based drillers, but not for the ultra-deep water drillers. In our view, these trends will stay intact over the coming months.



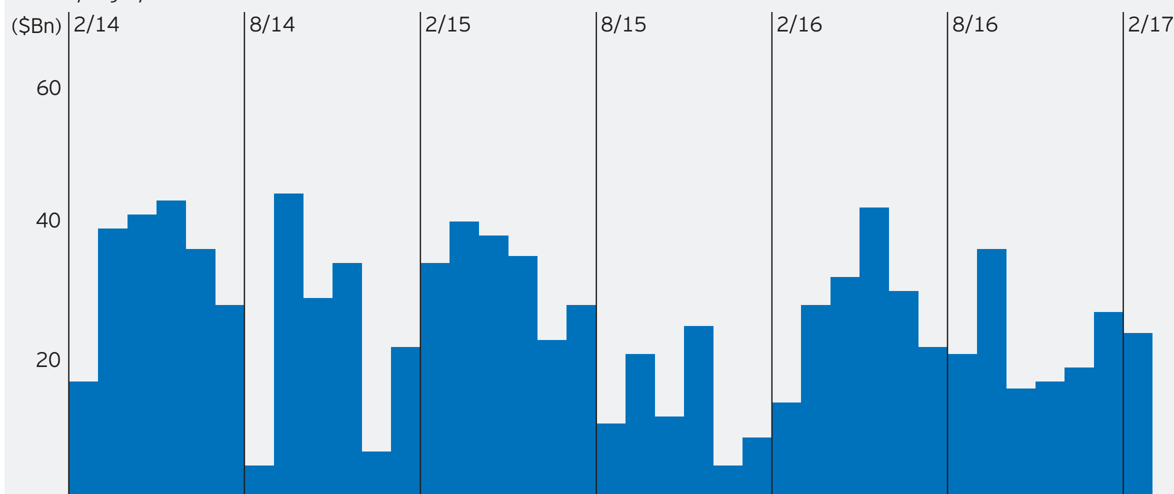
Source: JP Morgan, as of February 28, 2017

Fundamentals[2]

- The Bloomberg Barclays US Corporate High Yield 2% Issuer Capped Index finished the month with a yield-to-worst of 5.58%, a modified duration of 3.95, an option-adjusted spread of 363 bps, and an average price of $101.7.
- There was only one default in February in the high yield market which caused the par-weighted default rate to fall to 2.82% from 3.59% in January. Excluding energy, and metals and mining, the default rate is only 0.70%.
- Credit metrics for the overall market continue to reside in a healthy zone, in our opinion.
- Recent leverage statistics have improved as some energy companies announce improved earnings. Given the weight of the sector, this has had a beneficial impact on overall leverage ratios for the market.

Technicals

- High yield mutual funds reported an inflow in February of $1.5 billion after a flat January.
- February issuance dropped off modestly with net new issuance totaling $24.1 billion compared to $26.5 billion in January. Average monthly issuance in 2016 was $24 billion.
- New issuance was led by refinancing activity which represented 71% of new deals.
- High yield issuance has decreased over the past few years, which should bode well for technicals.



Source: JP Morgan, as of February 28, 2017

Relative value

- High yield offers a relatively low duration and a high coupon, which reduces its sensitivity to interest rate movements. However, as spreads tighten, the sensitivity to Treasury rates has grown.
- After a strong run during most of 2016, we expect the pace of high yield gains to continue to moderate.
- The spread between high yield and investment grade has fallen to 224 bps which is over 100 basis points below the historic median, but continues to provide an opportunity for yield pick-up given a manageable default risk.

Index returns (%)

	10/16	11/16	12/16	1/17	2/17	YTD 2017
Bloomberg Barclays US HY 2% Issuer Cap Index	0.39	-0.47	1.85	1.45	1.45	2.93
Bloomberg Barclays US Aggregate Bond Index	-0.76	-2.37	0.14	0.20	0.67	0.87
Bloomberg Barclays US Treasury 5-10 Year Index	-1.11	-3.39	-0.12	0.22	0.62	0.85
JPM EMBI Global Diversified Index	-1.24	-4.09	1.33	1.44	2.00	3.48
S&P 500 Index	-1.82	3.70	1.98	1.90	3.97	5.94
S&P/LSTA Leveraged Loan Index	0.72	0.18	1.29	0.34	0.50	0.84

Source: Barclays, JP Morgan and Standard & Poor's, as of February 28, 2017

1 Source: Barclays
2 Source: JP Morgan

About risk

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